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# Commonwealth of Massachusetts

## DEPARTMENT OF PUBLIC UTILITIES

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BOSTON GAS COMPANY

D.P.U. 96-50

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### REPLY BRIEF OF THE MASSACHUSETTS OILHEAT COUNCIL, INC.

#### I. INTRODUCTION

This brief is submitted on behalf of the Massachusetts Oilheat Council, Inc. ("MOC") in accordance with the amended procedural schedule adopted by the Hearing Officers<sup>1</sup>, and responds to various arguments and claims raised in the Initial Brief of Boston Gas Company ("IB \_\_\_\_").

#### II. THE COMPANY HAS FAILED TO JUSTIFY THE

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<sup>1</sup> Boston Gas Company, D.P.U. 96-50, Memorandum from Selma Urman, Hearing Officer, dated October 3, 1996.

## **PERFORMANCE-BASED REGULATION PROPOSAL**

The Company contends that the performance based regulation proposal (PBR) is consistent with the policy goals enunciated by the Department in Incentive Regulation, D.P.U. 94-158, and that the components of the formula are reasonable (IB pp. 41, et seq.). In some detail the Company attempts to justify the PBR productivity factor, consumer dividend, exogenous factor and other components of the price cap formula. Nonetheless, the Company's analysis misses the forest for the trees and fails to address the central issue governing the process of incentive regulation.

As set forth in D.P.U. 94-158, incentive regulation is intended to improve the rate setting process by effectively replicating market forces, and increase the "incentive" for the utility to operate more efficiently and economically. The proponent of a incentive ratemaking proposal must demonstrate that the approach offered is more likely than current regulation to advance the Department's goals of safe and reliable energy service and promote the objectives of economic

efficiency, cost control, lower rates and reduced administrative burden (D.P.U. 94-158, p. 57).

Unfortunately, the price cap proposal now presented by the utility is not an incentive mechanism, but merely an effort to modify the existing rate-setting mechanism in a manner which does not increase the utility's risk but enhances its ability to increase rates on a more regular basis.

The incentive regulation scheme codified in the PBR proposal does not, in reality, create any substantial transfer of risk which engenders greater efficiencies and ultimately reduce rates. To the contrary, neither in the record nor in brief does Boston Gas identify any specific rate reduction that will accrue as a result of the implementation of the PBR; it merely focuses on particular components which in the final analysis will shield the utility from its major risk elements while allowing it to act in a more competitive nature.

Under these circumstances the PBR as proposed fails to meet the goals of incentive regulation and the interests of ratepayers.

**III. THE PROPOSED CUSTOMER CHARGE INCREASES ARE  
UNREASONABLE AND SHOULD BE MODIFIED**

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The Company opines that the proposed schedule of increases in the customer charge over the life of the PBR are reasonable and accurately reflect the results of its cost of service studies (IB pp. 81-2). The Company further notes that as proposed a large portion of residential heating customers will have annual increases of 7% or less, which the Company deems unobjectionable (Id., p. 82). Once again, the Company fails to address the concerns which were raised by MOC and other parties as well.

The fact remains that over the term of the PBR, the customer charge will increase by 131% (D.P.U. 96-50 Vol. 10, p. 63), and low use customers will be disproportionately impacted. Although the Company mitigates this concern by focusing primarily upon larger use customers (IB p. 82), lower volume customers will view the PBR as a mechanism to increase their rates and charges rather than to improve the efficiency of utility service. The principals of gradualism and continuity,

while allowing some increase in the customer charge, are at odds with the massive and disproportionate increases posed by the Company. Accordingly, MOC's proposal that any increase awarded in this proceeding and throughout the term of the PBR will be recovered equally through the customer charge and usage rates, is reasonable and should be adopted.

#### **IV. PREDATORY PRICING**

In brief, MOC contended that predatory pricing, which is prohibited by the Federal antitrust laws, may be deemed to occur when a utility prices its services which are subject to competition to only recover marginal costs (Brief of MOC, pp. 22-25). The utility avers that MOC's claim was directed to the pricing for all transportation services, as well as its pricing flexibility proposal (IB pp. 83-4). The utility further argues that predatory pricing would not occur because no intent to engage in such activity has been shown, the prices would not be below cost, and there is no demonstration that the Company would be able to recoup its losses (IB pp. 84-5).

Initially it should be noted that the claim of predatory pricing raised by MOC is directed to the situation where the utility prices its product to only recover marginal costs and below the total costs associated with providing a particular service. Whether this occurs within the guise of pricing flexibility or the setting of transportation rates, the issue of predatory pricing arises and must be carefully examined and addressed by the Department.

With respect to the issue of intent to engage in predatory pricing, it is clear from the record in this proceeding that the Company seeks to strengthen its market presence through the vehicle of pricing flexibility and its pricing for services which are subject to competition (BGC Exhibit 3, pp. 42-3). The stated intent of impacting competition must also be examined in the context of the utility's monopoly position, whereby in connection with the provision of natural gas service it retains a monopoly on local transportation service. And with respect to the total energy market where in excess of 40% of the available homes use natural gas, its ability to gain a dominant

share of the market and retard competition remains a real possibility. While the issue of "intent" will ultimately have to be decided by a trier of fact in a court of law, a concern that predatory pricing may arise is sufficiently developed in the record in this proceeding to warrant review by the Department.

Moreover, pursuant to the holding in Brooke Group, Ltd. v. Brown and Williamson Corp., 113 S.Ct. 2578 (1993), predatory pricing occurs when a product price is below an appropriate measure of the challenged party's total cost. The Court did not specifically determine how low prices have to be in order to be considered predatory, but based upon subsequent rulings, even where prices are above average total costs, predatory pricing could be deemed to occur. See, Transamerica Computers v. IBM, 698 Fed.2d 1377 (9 Cir.). Therefore, pricing at marginal cost alone, can be sufficiently violative of the pricing standard by which predatory pricing is measured.

The probability of the Company recouping its losses from below cost pricing depends upon the particular service offered, how long it is offered, and the degree to which the utility is able to increase its



market share as a result of its predatory activity. Of course, these questions can only be answered after the Company has implemented a particular pricing scheme in a particular market. But, more importantly, by that time the competitive harm will have occurred and damage to the market will have been inflicted. It is safe to assume that the Company's pricing scheme will be developed on the premise that within an acceptable period of time its investment will be recovered and its short-term decrease in revenues will be offset by an increased market share.

Obviously a final determination on whether predatory pricing is deemed to occur will be made by a court of law; however, given the Commission's stated intention of allowing consumers to benefit from increased competitive choices, it is necessary to ensure that the regulatory scheme approved in this proceeding does not run afoul of the federal antitrust laws, and does not allow the utility to retard the market and thereby harm the interests of ratepayers.

## **V. CONCLUSION**

For the foregoing reasons, MOC respectfully  
urges the Department to render a decision consistent with  
the recommendations presented by MOC.

Respectfully submitted,  
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